

NO. 88673-3
SUPREME COURT
OF THE STATE OF WASHINGTON

EXPEDIA, INC., a Washington Corporation; EXPEDIA, INC., a Delaware Corporation; HOTELS.COM, L.P., a Texas Limited Liability Partnership; HOTELS.COM, GP, LLC, a Texas Limited Liability Company; HOTWIRE, INC., a Delaware Corporation; TRAVELSCAPE, a Nevada Limited Liability Company,

Plaintiffs/Petitioners,

v.

STEADFAST INSURANCE COMPANY, a Delaware Corporation;
ZURICH AMERICAN INSURANCE COMPANY, a New York Corporation;
ROYAL & SUN ALLIANCE, a Foreign Corporation;
ARROWPOINT CAPITAL CORP., a Delaware Corporation;
ARROWOOD SURPLUS LINES INSURANCE COMPANY, a Delaware Corporation;
ARROWOOD INDEMNITY COMPANY, a Delaware Corporation,

Defendants/Respondents.

PLAINTIFFS/PETITIONERS' REPLY BRIEF IN FURTHER SUPPORT
OF PETITION FOR REVIEW

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STATE OF WASHINGTON

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I. INTRODUCTION

The decisions below completely disregard the rules governing the duty to defend that have been put in place by this Court over decades of jurisprudence. Contrary to Washington law, the decisions permit Zurich to a) refuse to defend Expedia even though Zurich has not met its burden of showing there is no potential for coverage, b) delay adjudication of Expedia's duty to defend while Zurich pursues discovery extrinsic to the policies and complaints, and c) pursue discovery into issues that overlap with matters at issue in the underlying lawsuits against Expedia, contrary to Zurich's duty of good faith. Expedia seeks this Court's review to rectify those fundamental and prejudicial errors of Washington law.

Rather than confront these errors on the merits, Zurich attempts to cast this as a discovery dispute and devotes the majority of its brief to expounding upon the standards for review under RAP 13.5(b) because it knows that the decisions below cannot withstand appellate scrutiny. But Expedia is entitled to review under multiple provisions of RAP 13.5(b). The decisions below were error in all respects—obvious, probable, and far departed from the ordinary and usual course of proceedings. Under RAP 13.5(b)(3), nothing more is required and review is thus warranted. Expedia also satisfies the other provisions of the rule because the decisions below substantially limit Expedia's freedom to act—including in

the underlying lawsuits—and risk rendering further proceedings useless.

II. ARGUMENT

A. The Decisions Below Commit Fundamental Errors of Washington Law Concerning an Insurer’s Duty to Defend.

The decisions below fundamentally err by depriving Expedia of the essential benefits of the substantive policyholder rights guaranteed by the duty to defend. The central aspect of the duty to defend is that it is an active and ongoing duty—one that must be provided during the pendency of the underlying litigation for so long as the potential for coverage exists—rather than reimbursement after the fact. *Am. Best Food, Inc. v. Alea London, Ltd.*, 168 Wn.2d 398, 405, 229 P.3d 693 (2010). For this reason, this Court has adopted rules that ensure that insurers will not desert their policyholders while they attempt to develop the evidence necessary to justify their denial. *Id.* The “immediate imposition” of the duty to defend is not simply a procedural nicety that a trial court can ignore; it is “necessary to provide to an insured the full benefits due under the policy.” *Haskel v. Superior Ct.*, 33 Cal. App. 4th 963, 968 (1995).

An early adjudication of the duty to defend is necessary to provide the substantive benefits for which the policyholder bargained. To ensure the benefits of a defense, courts in Washington—and in states that follow similar duty to defend principles—have adopted an ordinary course of proceedings in cases like this where an insurer has refused to defend and

instead forces its policyholder to sue. Any motion seeking a ruling that the duty to defend has arisen is decided immediately based on the eight corners of the policy and underlying complaint. *Woo v. Fireman's Fund Ins. Co.*, 161 Wn.2d 43, 52-53, 164 P.3d 454 (2007). If there is a potential for coverage, the court orders the insurer to defend "until it is clear that the claim is not covered." *Am. Best*, 168 Wn.2d at 405. Disputed issues of fact relating to the insurer's defenses do not justify denial or delay of the policyholder's motion; instead, such factual disputes confirm the existence of the duty to defend. *Id.*; *Anthem Elecs., Inc. v. Pac. Empr's Ins. Co.*, 302 F.3d 1049, 1060 (9th Cir. 2002); *SmartReply, Inc. v. Hartford Cas. Ins. Co.*, 2011 WL 338797, at *2 (W.D. Wash. Feb. 3, 2011).

Once the duty to defend motion is resolved, the insurer may pursue discovery into its defenses to meet its burden of proving that no possibility for coverage exists. However, when such discovery is pursued, courts assess the overlap between the issues in the coverage case and the issues being litigated in the underlying lawsuits. Where issues overlap or raise the potential for prejudice, courts preclude insurers from litigating (or taking discovery into) those issues until they are resolved in the underlying case to avoid potential prejudice to the policyholder. *Montrose Chem. Corp. v. Superior Ct.*, 6 Cal. 4th 287, 301-02, 861 P.2d 1153 (1993); *Haskel*, 33 Cal. App. 4th at 979; Thomas V. Harris, *Washington*

Insurance Law, § 14.02 (3d ed. 2010). The presence of unresolved overlapping issues, however, does not justify excusing the insurer from its ongoing obligation to defend. *Time Oil Co. v. Cigna Prop. & Cas. Ins. Co.*, 743 F. Supp. 1400, 1419-20, 1422 (W.D. Wash. 1990).

This is the “usual course of judicial proceedings” followed in *Time Oil*, *Montrose*, *Haskel*, *SmartReply*, and countless other cases. The orders of the courts below, however, represent a complete and unjustified departure from that usual course.¹ The courts refused to allow Expedia’s motion to be heard promptly on the basis of the relevant policies and complaints. Instead, they held that discovery into Zurich’s defenses *must* be completed before Expedia’s motion would be considered.² And they so held even though the discovery Zurich seeks overlaps with matters at issue in the underlying lawsuits, as both courts acknowledged.

Zurich’s argument that this Court should nonetheless decline to

¹ Washington courts have accepted review under the departure from the ordinary course standard for issues as discrete as refusing to permit a plaintiff to use certain deposition testimony at trial, *see Young v. Key Pharms., Inc.*, 63 Wn. App. 427, 431, 819 P.2d 814 (1991), or refusing a party access to certain records, *see Folise v. Folise*, 113 Wn. App. 609, 613, 54 P.3d 222 (2002). The drastic departure from the ordinary course on fundamental insurance issues that, as *amici curiae* explained, affect policyholders across the state meets the standard here.

² The Superior Court clearly confused the duty to defend with the duty to indemnify when it found that the discovery Zurich pursued was necessary to resolve Expedia’s motion “on the merits.” A.21. The merits of Expedia’s motion solely concern whether the relevant underlying complaints potentially give rise to coverage under the relevant policies, a question determined exclusively by those complaints and policies under Washington law. *Woo*, 161 Wn.2d at 53-54. Whether Expedia is actually entitled to indemnity for any liabilities incurred in the underlying lawsuits is a different question, decided on different evidence, than the duty to defend issue raised by Expedia’s motion.

intervene because the orders below are mere procedural discovery orders (Opp'n at 14) ignores the fundamental nature of a policyholder's right to a prompt determination of the insurer's duty to defend.³ Indeed, Zurich's argument was rejected in *Haskel* because it "confuses the principles surrounding the creation of a defense obligation." 33 Cal. App. 4th at 977. *Haskel* accepted discretionary review to ensure that those principles were applied correctly by the trial court. This Court should do the same.

B. The Decisions Below Erroneously Graft Policyholder-Specific Considerations onto the Duty to Defend Analysis.

The courts below relied on two circumstances supposedly "unique" to Expedia to justify their drastic departure from the ordinary course of litigating duty to defend issues under Washington law: 1) that Expedia was a large corporate entity that had been "driving the bus" on its defense and thus would not be prejudiced by a delay in adjudication of the duty to defend; and 2) that Expedia provided late notice for certain underlying lawsuits. These considerations fundamentally alter the standard approach to the duty to defend in ways that Washington law simply does not permit.

First, it is axiomatic that Washington law does not treat large corporate insureds differently from smaller companies or individuals.

³ In any event, even procedural orders merit discretionary review when they depart from the ordinary course. See *Wahler v. Dep't of Social & Health Servs.*, 20 Wn. App. 571, 582 P.2d 534 (1978); *Lurus v. Bristol Labs., Inc.*, 89 Wn.2d 632, 574 P.2d 391 (1978).

Insurance policies are contracts—often standard form contracts—and issues related to the scope of coverage provided by those contracts apply equally to large and small policyholders. *See Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 883, 784 P.2d 507 (1990). Expedia is not aware of *any* prior decision of the Washington courts that offered reduced coverage to a policyholder simply because it was a large corporation.

Second, the courts below wrongly placed the burden on *Expedia* to show prejudice in order to obtain defense coverage. Again, Expedia is not aware of any prior decision of the Washington courts holding that the duty to defend is available only to policyholders who first make a showing of prejudice.⁴ In fact, the opposite is true: it is the *insurer* who must prove (not merely suggest) actual and substantial prejudice in order to extinguish its defense obligation. *See Nat'l Sur. Co. v. Immunex Corp.*, 176 Wn.2d 872, 297 P.3d 688, 695-96 (2013); *Mut. of Enumclaw Ins. Co. v. USF Ins. Co.*, 137 Wn. App. 352, 360-61, 153 P.3d 877 (2007).

Expedia is not required to prove indigency or to rebut Zurich's late notice defense in order to receive the defense coverage promised by the policies. Those considerations are irrelevant to the issues raised by Expedia's duty to defend motion, which is whether the underlying

⁴ This would be an absurd requirement. *Every* policyholder is prejudiced when its insurer refuses to defend because the policyholder must then fund the cost of defense itself. A potential right to reimbursement many years down the road cannot cure that prejudice, contrary to the conclusion of the Superior Court here.

complaints assert claims that potentially are covered by the policies.⁵

The lower courts' rulings concerning late tender also are contrary to the record. Expedia tendered the first lawsuit within months of service and was promptly denied coverage. The majority of the underlying lawsuits at issue in the case were filed in 2008 or later, within two years of Expedia's 2010 tender. Not surprisingly, Zurich's response to that tender was identical to the first—coverage denied. Zurich cannot show—and has made no attempt to show—that its response would have been different had some of the cases tendered in 2010 been tendered earlier. In any event, the circumstances of Expedia's tender at most give rise to issues of fact concerning whether late notice is a defense to coverage. Such issues of fact cannot excuse Zurich from its defense obligation, particularly in light of its inability to prove, or even allege, actual and substantial prejudice.

C. The Decisions Below Deprive Expedia of Substantive Rights and Substantially Limit Its Freedom to Act.

The Court of Appeals fundamentally erred in holding that Expedia is not prejudiced or restricted by the Superior Court's order because that court offered "alternatives" to the protective order Expedia requested.

⁵ The cases cited in footnote 3 of Zurich's Answer involve rulings in insurers' favor on *insurers'* motions for summary judgment. They say nothing about whether a policyholder's right to obtain adjudication of the duty to defend must await completion of discovery into the insurer's defenses. Zurich does not cite a single Washington decision permitting the deferral of adjudication of the duty to defend pending discovery into matters extrinsic to the policies and the complaints.

Both Zurich and the Court of Appeals ignore the primary relief sought by Expedia's motion at the trial court: immediate consideration of Expedia's motion for summary judgment as to the existence of the duty to defend. None of the supposed alternatives allows for this relief, therefore none of them cures the harm to Expedia resulting from the orders below.⁶

Washington law offers Expedia two fundamental rights that are adversely impacted by the decisions below. First, Expedia is entitled to prompt and ongoing defense coverage for so long as there is any possibility that the underlying claims are covered. Second, Expedia is entitled to protection from litigation into issues that overlap with, and thus could prejudice Expedia in, the underlying lawsuits. *See Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.*, 161 Wn.2d 903, 918, 169 P.3d 1 (2007). Expedia is entitled to both of these rights; Washington law does not condone the forced deprivation of one as a consequence of pursuing the other. Indeed, this is exactly what *Haskel* holds. The court there ruled both that the trial court was "required to consider Haskel's motion for summary adjudication" on the duty to defend *and* that Haskel was "entitled to a stay of discovery on issues which prejudice its defense of the underlying action." 33 Cal. App. 4th at 975, 978. Only by

⁶ RAP 13.5(b)(3) does not require Expedia to show a substantial limitation of its freedom to act; the significant departure from the ordinary course of proceedings is enough to merit review by itself. Probable error resulting in substantial limitation of Expedia's freedom to act is an independent ground for review under RAP 13.5(b)(2).

enforcing both rights now, at this stage of the litigation, can this Court provide Expedia with the protection that Washington law provides.

Zurich's contention that a complete stay is sufficient to protect Expedia ignores that this result forever deprives Expedia of its right to ongoing defense coverage while the underlying lawsuits are pending. Zurich claims that *Haskel* and *Montrose* both support this approach, but those cases employed a discovery stay only *after* the duty to defend had been adjudicated and was in place to benefit the policyholder. The stay in *Montrose* came only after the defense obligation was in place. *See* 6 Cal. 4th at 300. The same is true in *Haskel*—the court remanded the case so that the duty to defend could be adjudicated and ordered the court to consider which discovery would proceed and which must be stayed only *after* the duty to defend was adjudicated. This is the only approach condoned by Washington law, the approach the courts below should have followed, and the approach this Court should impose now.

Finally, there is no real question that the courts' orders substantially limit Expedia's freedom to act. Forcing Expedia to proceed with litigation of overlapping issues to obtain the defense coverage to which it is entitled—as the courts below have done—necessarily prejudices Expedia in the underlying cases. For example, Zurich seeks to have Expedia prove its own negligence, which could subject it to liability

in the underlying lawsuits. This is the classic situation when a stay against discovery is required. *Montrose*, 6 Cal. 4th at 301-02. Lack of a defense also impacts Expedia's case and settlement strategy in the underlying litigation. Moreover, Expedia does not have infinite resources. Delaying and denying Expedia its defense forces Expedia to direct its resources away from corporate, charitable, or other designated uses toward funding both expensive underlying litigation and this coverage action. Absent relief, Expedia will be required to engage in prolonged discovery that this Court consistently has held is not relevant to the issue of whether the duty to defend has arisen—a useless exercise.

Expedia has an “unrestricted right to prosecute a concurrent [coverage] action” and is “not required to await the resolution of the [underlying] claim,” particularly when its insurer has refused to provide a defense. *Harris*, *supra*, § 14.02. The orders below deny Expedia that right and impose restrictions that Washington law does not permit. The lower courts' refusal to adjudicate the duty to defend prejudices Expedia. That prejudice is compounded by the fact that Expedia cannot obtain an ongoing defense without subjecting itself to overlapping discovery. The orders below thus limit Expedia's freedom to act by forever denying it the substantive rights guaranteed by Washington insurance law; namely, an ongoing defense free from prejudice caused in the underlying litigation.

DATED this 20th day of May, 2013.

Respectfully submitted,

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DECLARATION OF SERVICE

I, Heather Bond, declare under penalty of perjury that I am over the age of 18 and competent to testify and that the parties listed below were served in the manner listed below:

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